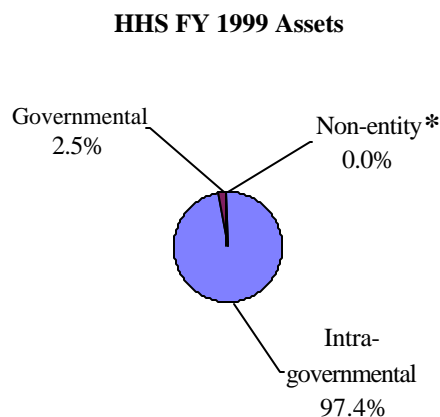


ANALYSIS OF FINANCIAL POSITION (BALANCE SHEET)

ASSETS

HHS had over \$271.6 billion in total assets (including non-entity assets) at the end of FY 1999, compared to \$235.3 billion at the end of FY 1998. This 15.4% increase is due largely to increased balances in the Medicare Trust Funds and in Fund Balances with Treasury.

The balance sheet separately identifies intragovernmental assets from all other assets. The bulk of HHS' assets are intragovernmental, meaning that they are HHS claims against other Federal agencies. These are for accounts such as the Medicare Trust Funds' Investments in U.S. Treasury Securities and the Fund Balance at Treasury.



Most HHS assets are Medicare's claims on the U.S. Treasury, and are categorized as Intragovernmental.

*** Note: Non-entity assets were far less than .1% of total assets.**

Assets Analysis by Account Type

Investments (at \$184.8 billion) remains the largest HHS Asset. It is made up almost 68% of total assets at FYE 1999, compared to 69% (\$161.9 billion) in 1998. These investments represent the cumulative excess of collections and appropriations over expenditures of the Medicare HI and SMI trust funds, which are invested with the U.S. Treasury Special Issue Securities. Treasury, in turn, uses these funds to finance other operations of the Federal Government thus reducing the need for Federal borrowing from the public. These securities had been accumulating since the inception of the Medicare program in 1966. According to the 1999 Trustees Report, 1995 was the first year that expenditures exceeded income and Medicare started to call upon its Trust Fund resources. These resources will continue to be called upon in years where annual expenditures exceed revenues.

Unlike the assets of private pension plans, Medicare trust funds do not consist of real economic assets that can be drawn down in the future to fund benefits. Instead, they are claims on the Treasury that, when redeemed, will have to be financed by raising taxes, borrowing from the public, or reducing benefits or other expenditures. When financed by borrowing, the effect is to defer today's costs to even later generations who will ultimately repay the funds being borrowed for today's Medicare beneficiaries. The existence of large trust fund balances, therefore, does not make it easier for the Government to pay benefits. Reflecting both the law and existing Federal accounting standards, no liability is recorded for benefits which may be paid in the future on behalf of today's workers who are currently paying taxes into the trust funds and who expect to be future beneficiaries upon their retirement.

The next largest category of assets is ***Fund Balance with Treasury*** at approximately 27%, which represents other undisbursed balances (largely appropriated funds, but also amounts related to revolving and other funds) held at the Treasury Department (which acts as a sort of bank for HHS).

Accounts Receivable from the Public (Net), at \$4.3 billion and ***Loans Receivable (Net)*** at \$401 million represent a total of only 1.8% of HHS assets, but are the focus of a great deal of attention with respect to our debt collection initiatives, which are covered elsewhere in this report. Medicare's Contractor Accounts Receivable (which makes up the substantial portion of HHS Accounts Receivable) had been the subject of a qualification in prior auditor's reports and presented a significant barrier to both HCFA and HHS "clean opinions" until a major effort was undertaken during FY 1999 to analyze and verify the subsidiary account records. The effort resulted in the write-off of \$2.9 billion in Medicare contractor receivables. For further details, see financial statement footnote number four in Section IV.

Property, Plant and Equipment (PP&E), at almost \$1.8 billion (net of accumulated depreciation) amounts to less than one percent of total assets, and is largely concentrated at NIH (numerous high technology research centers with high technology equipment), IHS (many facilities), FDA, and CDC. Since FY 1997, the capitalization threshold was increased from \$5 thousand to \$25 thousand, reducing the burden of accounting for smaller equipment purchases.

Assets Analysis by Budget Function

When assets are analyzed by budget function (see supplemental schedules in Section IV), Medicare (with its own budget function category) holds the vast majority (70%) of HHS assets (composed largely of the Trust Fund account balances). The health budget function (which covers the Medicaid program, NIH, HRSA, CDC, SAMHSA, IHS, FDA and AHCPR), the second largest (18%), is composed mostly of Fund Balances with Treasury, with lesser amounts attributed to Investments and PP&E.

LIABILITIES

Relative to HHS assets, there are few liabilities. This is because neither Federal law nor Federal accounting standards recognize any long term liabilities associated with covering future Medicare costs for today's workers contributing to the system today who become beneficiaries

upon their retirement. In other words, the amount of trust fund assets accumulated over more than three decades do not have an offsetting liability for future retirees.

Most of the HHS liabilities represent an estimate of accrued ***Entitlement Benefits Payable*** associated with the Medicare and Medicaid programs.

The noteworthy item in the HHS liabilities is the amount of ***Liabilities Not Covered by Budgetary Resources***, which are largely unfunded pension expenses of the Commissioned Corp recognized at PSC, but also include accrued annual leave and disability compensation for employees at all OPDIVs. The inherent differences between the way funds are appropriated in the Federal budget process, and how they are accounted for under generally accepted accounting principles (GAAP) cause these unfunded liabilities. Budgets are formulated on more of a cash basis, while GAAP is on an accrual basis. In other words, financial (accrual) accounting recognizes that the cost of today's HHS employees consists of today's salaries and benefits actually received, as well as the accrual of benefits to be paid out at a later date (for a "full cost" amount). Budgetary accounting delays recognizing the earned but unpaid benefits for years, until the payments are actually made to the employees/retirees. The Federal budget process does not recognize the future employee benefits costs of today's employees, but instead budgets for those future expenses in the future years when they are actually paid. The result is that while employee expenses (present and future) are recognized in accrual-based financial statements, they are under-represented in the cash-based Federal budget. This is one excellent example of the benefits of accrual accounting financial statements; there are no surprises regarding liabilities for employee benefits.

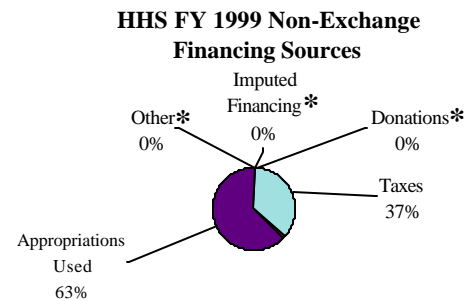
NET POSITION: BALANCE SHEET AND STATEMENT OF CHANGES

Net Position is the difference between total assets and total liabilities shown on the balance sheet. Starting in FY 1998, net position was broken down into two categories: unexpended appropriations and cumulative results of operations.

Unexpended Appropriations is the amount of authority granted by Congress that has not been expended or used. It is mostly attributed to ACF, NIH, and HCFA.

Cumulative Results of Operations are the net results of operations since inception, plus the cumulative amount of prior period adjustments. HCFA accounts for most of the balance in the account.

The Statement of Changes in Net Position begins with the net cost of operations (taken from the Statement of Net Costs) and nets these costs with all sources of financing HHS received in FY 1999 (through appropriations or otherwise) to attain net results of operations. That amount is added to the increase in the amount of unexpended appropriations to determine the change in net position from FY 1998 to FY 1999. The amount of the change is then added to the Net Position beginning balance to arrive at the ending balance of \$224 billion. This statement provides more detailed information on non-exchange financing sources than can be found in other statements.



The HHS FY 1999 Statement of Changes in Net Position reveals that general appropriations and taxes are the largest source of non-exchange financing.

*** Note: Imputed Financing, Donations, and Other Financing Sources were far less than .1% of the total.**